Privy Council Appeal Nos. 17,18 and 19 of 1984

Phillip William Carney *Appellant*

v.

John Edward Herbert and Others *Respondents*

FROM

THE SUPREME COURT OF NEW SOUTH WALES

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 29TH OCTOBER 1984

Present at the Hearing:

LORD FRASER OF TULLYBELTON
LORD SCARMAN
LORD DIPLOCK
LORD ROSKILL
LORD BRIGHTMAN

*[Delivered by **Lord Brightman**]*

These three consolidated appeals are from a decision of His Honour Mr. Justice Rogers sitting in the Supreme Court of New South Wales, pursuant to leave granted by that Court. The case is concerned with the right of a transferee of shares, under a contract for the purchase thereof, to avoid paying for the shares on the ground that the contract involved illegal acts, namely, the giving by a holding company and its subsidiary of financial assistance in connection with a purchase of shares in the holding company, contrary to section 67 of the Companies Act 1961. In consequence of the illegality, it is said, the purchaser is entitled to retain the shares without paying for them. Mr. Justice Rogers rejected this defence, and the purchaser now appeals to Her Majesty in Council.

The company whose shares formed the subject matter of the contract is Airfoil Registers Pty. Limited ("Airfoil"). At the relevant time there were 111 shares in issue; 93 shares were held by Mr. Carney, the appellant, whose company Ilerain Pty. Limited [43] ("Ilerain") contracted to purchase the remainder of

the shares; 5 shares were held by the respondent Mr. Herbert; 8 shares were held by the respondent Mr. Jehnic; the remaining 5 shares were held by the respondent Mr. Arnett. The appellant and the respondents were the directors of Airfoil.

A further company involved in the story is Newbridge Industries Pty Limited ("Newbridge"). This was a subsidiary of Airfoil. The appellant and the respondents were also the directors of Newbridge.

At the beginning of the year 1980, when it had become apparent to the shareholders that their continued association in Airfoil was undesirable, Mr. Carney informed his colleagues that he was prepared to buy their shares at a price based upon the net value of the assets of the company, the purchase to be taken in the name of a company which would be notified to them. After some negotiation on the purchase price, agreement was reached on 17th March. The price payable to Mr. Herbert was to be $114,800. As however he was indebted to Airfoil on a loan account in the sum of $5000, the sum payable to him would be reduced to $109,800. The price payable to Mr. Arnett was to be $106,500. The price payable to Mr. Jehnic was to be $183,700, but as he was indebted to Airfoil on a loan account in the sum of $7000, the sum payable to him would be reduced to $176,700. Mr. Carney made it clear that he would not be able to pay the whole of the purchase price at once. Moreover, he did not want any documentation at all. With this in mind, he wrote out nine cheques for the agreed purchase prices, and handed them to the proposed vendors. The cheques were as follows:-

Date of Cheque	Mr. Herbert	Mr. Jehnic	Mr. Arnett
24th March 1980	$41,000	$68,000	$41,000
31st July 1980	$23,000	$37,000	$28,000
15th August 1980	$45,800	$71,700	$37,500

Each cheque was drawn on the account of Airfoil at the Padstow branch of the Commercial Bank of Australia Limited and signed by Mr. Carney on behalf of Airfoil.

The vendors then sought advice from their accountant. As a result of the advice given to them, a further meeting was held on the following day with Mr. Carney to discuss the question of securing payment of the purchase price. Mr. Justice Rogers summarised the evidence of that meeting as follows:-

> "According to Mr. Arnett he told the defendant 'We will require some sort of security to ensure that we get paid'. Mr. Carney replied 'Everything I have is mortgaged. The only other thing I have is my interest in Airfoil'. Mr. Arnett replied to Mr.

Carney 'If everything you have is mortgaged, could we consider a mortgage over the factory?' Mr. Carney said 'Yes, but you will have to arrange for it and you will have to pay for it.' There was then a discussion about the consent to the mortgage. Still in his evidence in chief Mr. Arnett said that on that occasion he also made the statement, not quite the one ascribed to him by the defendant but the following 'If we don't get security we will not proceed'. The significant omission is the word 'the'. As I say, I accept Mr. Arnett's evidence about what transpired and have to consider the consequences of that arrangement on that basis."

The factory referred to belonged to Newbridge.

In the meantime Mr. Simpson, the solicitor for the vendors, had been consulted. He drew up certain documents. They consisted of three sale agreements and three mortgages, each of which was dated 21st March 1980. They were handed to the vendors, who passed them on to Mr. Carney for his consideration. Their Lordships will take the Arnett documents as representative.

The sale agreement was in the form of a Deed expressed to be made between Mr. Arnett (" the Vendor") of the first part and Ilerain ("the Purchaser") of the second part, Ilerain being the purchasing company notified by Mr. Carney. After brief recitals it went as follows:-

"1. The Purchaser shall pay to the Vendor the sum of one hundred and six thousand five hundred dollars ($106,500.00) such amount to be made by cash or bank cheque as follows:-

(a) As to the sum of $41,000.00 such sum to be paid on 24th March, 1980.

(b) As to the sum of $28,000.00 such sum to be paid on 31st July, 1980.

(c) As to the sum of $37,500.00 such sum to be paid on 15th August, 1980.

2. Upon receipt of the payment of the said $41,000.00 the Vendor shall execute a Transfer of the said shares in favour of the Purchaser in appropriate form and shall hand such Transfer to the Purchaser.

3. Should any payment due by the Purchaser to the Vendor under Clause (1) hereunder be in arrears exceeding fourteen (14) days from the due date then the Vendor shall be at liberty to immediately commence proceedings to recover the amount due as a liquidated sum."

In the case of Mr. Herbert and Mr. Jehnic, the purchase price expressed in each sale agreement was the reduced amount.

The mortgage document was to be executed by Newbridge, and was in the form of a mortgage to secure payment to Mr. Arnett of the purchase price due to him. It charged certain property of Newbridge, expressed to be subject to two prior incumbrances. The mortgage also contained a covenant by Newbridge for the payment of such sum to Mr. Arnett.

On 24th March a final meeting took place which was attended by the vendors, Mr. Carney, Mr. Carney's accountant and Mr. Simpson. At this meeting a seventh document was produced by Mr. Simpson, namely a guarantee. The guarantee was expressed to be made between Mr. Carney of the first part and the three vendors of the second part. In consideration of each of the vendors entering into the sale agreement with Ilerain, Mr. Carney agreed that, if Ilerain should make default in payment of the money due thereunder, he would pay the amount to the vendor. The seven documents were then executed, the shares were transferred to Ilerain and the cheques dated 24th March were presented and cleared.

The second instalments of the purchase price were due to be paid on 31st July. By that date the shares in Airfoil had been sold at what the learned judge described as an immense profit. The banking account on which the cheques had been drawn was closed, so that the cheques were worthless. New cheques were not tendered by Mr. Carney. Ilerain defaulted in the payment of the second and third instalments of the purchase price. On 1st September Mr. Simpson called on Mr. Carney to implement his guarantee. He failed to do this.

In October 1980 the vendors commenced proceedings against Mr. Carney on the guarantee. He defended the claim on the ground that the sale agreements were illegal and unenforceable by reason of the provisions of section 67 of the Companies Act 1961. Ilerain therefore had no obligations thereunder, and accordingly nothing was due from Mr. Carney under his guarantee.

Section 67 of the Companies Act is in the following terms:-

"67.(1) Except as is otherwise expressly provided by this Act no company shall, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, give any financial assistance for the purpose of or in connection with a purchase or subscription made or

to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase, deal in or lend money on its own shares.

(2) .....

(3) If there is any contravention of this section, the company and every officer of the company who is in default shall be guilty of an offence against this Act. Penalty: Imprisonment for three months or one thousand dollars."

The section is not significantly different from the comparable provisions of the legislation prevailing in England.

It is claimed on behalf of Mr. Carney that the transactions contravened section 67 in three respects, with the happy result, for Mr. Carney, that he and his company became entitled to retain the benefit of the shareholding in Airfoil which had been purchased without any liability for payment of the outstanding $243,000. The illegalities were said to be:-

(1) The fact that security was provided by Newbridge, a subsidiary of Airfoil;
(2) The fact that the purchase price was tendered by cheques drawn on Airfoil's bank account;
(3) The fact that Airfoil released Mr. Herbert and Mr. Jehnic from liability on their loan accounts.

The learned judge held Mr. Carney to his guarantee, and entered judgment for the vendors accordingly. The mortgages, though illegal and of no effect, could be severed from the sale agreements and the guarantee. The sale agreements required payment by cash or bank cheque i.e. what in England, their Lordships were told, would be called a bank draft; the alternative accepted by the vendors of payment by Airfoil cheques did not necessarily involve any breach of section 67. The release of the loan accounts was not, on the facts of the case, a breach of section 67. With all these conclusions their Lordships agree.

The Mortgage Point

The vendors do not dispute that the mortgages were illegal and void. The mortgages amounted to the provision of security by a subsidiary of the company whose shares were purchased and thus offended section 67. The vendors were therefore implicated, together with Mr. Carney, Airfoil, Ilerain and Newbridge, in an illegal act, namely a breach of statute law which amounted to a criminal offence.

The sale agreements, the guarantee and the mortgages are rightly to be viewed as concurrent steps in a single though composite transaction. The provision of the mortgages by Newbridge was a term forming part of the overall agreement reached between Mr. Carney, on behalf of himself and Ilerain, and the vendors. That term was illegal. A plaintiff cannot sue on an illegal agreement. The question therefore arises whether the illegality of the mortgages taints the whole transaction and prevents the vendors suing Ilerain upon the sale agreements and suing Mr. Carney on the guarantee, or whether the illegal mortgages can be severed for the purposes of the action from the overall transaction, leaving intact the rights of action against Ilerain and Mr. Carney because, by reason of such severance, a plaintiff would not need to sue on any illegal agreement.

Questions of severability are often difficult. There are no set rules which will decide all cases. As was said by Kitto J. in *Brooks v. Burns Philp Trustee Co. Limited* [1969] 121 C.L.R. 432, 438, tests for deciding questions of severability that have been formulated as useful in particular cases are not always satisfactory for cases of other kinds.

To some extent each case must depend on its own circumstances, and in particular on the nature of the illegality. Two colliery cases, *The Netherseal Colliery Co. Limited v. Bourne* [1889] 14 A.C. 228 and *Kearney v. Whitehaven Colliery Co.* [1893] 1 Q.B. 700, provide a useful starting point for a consideration of this branch of the law.

In the *Netherseal* case two miners were suing for the balance of their wages. In the *Kearney* case the colliery was suing a miner for damages for his failure to give the contractual period of notice before leaving his employment. In the latter case the miner sought to defeat the claim by relying on the illegality of a term in the contract which, it was said, rendered the entire contract of employment void. The same illegal term was present in both cases. It was a term, illegal by statute, which purported to authorize the colliery owner to make a deduction from a miner's wages in respect of coal brought to the surface of the mine which was so small as to pass through a screening device known as "Billy Fairplay". Neither the House of Lords nor the Court of Appeal had difficulty in upholding the claims of the respective plaintiffs despite the presence of this illegal term. It was not argued in the *Netherseal* case that the illegal term vitiated the whole contract, so severability was not an issue. It was nevertheless raised and disposed of by Lord Halsbury in his concluding observation that "... as the whole contract is not illegal but the deductions are not enforceable, the plaintiffs had a right to sue for the wages due to them without any such deduction".

Severability was directly in issue in the second case, and it may be helpful to quote from the judgment of Lopes L.J. (at page 713);-

> "The law is clear that where the consideration for a promise or promises contained in the contract is unlawful, the whole agreement is void. The reason is that it is impossible to discriminate between the weight to be given to different parts of the consideration, and therefore you cannot sever the legal from the illegal part. But where there is no illegality in the consideration, and some of the provisions are legal and others illegal, the illegality of those which are bad does not communicate itself to, or contaminate, those which are good, unless they are inseparable from and dependent upon one another. Here the consideration moving from the master to the men is the employment and the payment of wages. The consideration moving from the men to the master is the services rendered by them. Both are good and lawful considerations. Then we come to the stipulation with respect to deductions. I am of opinion that that stipulation is altogether separable from and independent of the consideration."

This approach was echoed by Jordan C.J. in *McFarlane v. Daniell* 38 S.R. (N.S.W.) 337. This was a case in which an actor sued for his remuneration under a contract of employment which contained a restrictive covenant which was void as being in unreasonable restraint of trade. The employer boldly contended that the actor could not recover his remuneration because the contract was wholly void. The learned Chief Justice said this (at page 345):-

> "When valid promises supported by legal consideration are associated with, but separate in form from, invalid promises, the test of whether they are severable is whether they are in substance so connected with the others as to form an indivisible whole which cannot be taken to pieces without altering its nature ... If the elimination of the invalid promises changes the extent only but not the kind of contract, the valid promises are severable ... If the substantial promises were all illegal or void, merely ancillary promises would be inseverable."

He added later (at page 346):

> "The exact scope and limits of the doctrine that a legal promise associated with, but severable from, an illegal promise is capable of enforcement, are not clear. It can hardly be imagined that a Court would enforce a promise, however inherently valid and however severable, if contained in a contract one of the terms of which provided for assassination."

Their Lordships agree with both observations. There are therefore two matters to be considered where a contract contains an illegal term, first, whether as a matter of construction the lawful part of the contract can be severed from the unlawful part, thus enabling the plaintiff to sue on a promise unaffected by any illegality; secondly, whether, despite severability, there is a bar to enforceability arising out of the nature of the illegality.

Miller v. Karlinski [1945] 62 T.L.R. 85 was a case before the English Court of Appeal which might have been decided against the plaintiff on the second ground instead of the first. An employee sued for his salary under an oral contract which provided for a fixed weekly salary plus "travelling expenses", such "travelling expenses" to include the income tax payable by the employee. It was held that as the plaintiff was to be paid according to a scheme devised so as to defraud the Revenue, the fraudulent element could not be severed from the remainder of the contract. Alternatively it might have been said that although as a matter of construction the obligation of the employer to pay travelling expenses, or alternatively the right of the employee to include income tax in such expenses, was severable from the remainder of the contract as a matter of construction, nevertheless it was contrary to public policy to allow the plaintiff to sue. However it seems unnecessary to decide whether in this type of case public policy should be regarded as barring the right to sever or as barring the right to enforce despite severability, as the end result will be the same.

The classic case where a contract containing an illegal provision was severed into its lawful and unlawful parts, and the lawful part enforced, was decided in 1962 by the High Court of Australia, *Thomas Brown & Sons Limited v. Fazal Deen* 108 C.L.R. 391. In that case the plaintiff Fazal Deen had lodged with the defendant in 1943 a safe containing gold and gems under a contract of bailment. The bailment was illegal as regards the gold, which ought to have been delivered to the Commonwealth Bank under exchange control regulations. The contents of the safe disappeared in unexplained circumstances at some time during the ensuing sixteen years, whereupon the plaintiff sued the company in detinue. The company resisted the claim on the ground, *inter alia*, that the entire contract of bailment was tainted by the illegality of the bailment of the gold. The High Court approved the observation of Jordan C.J. in *McFarlane's* case that "... if the elimination of the invalid promises changes the extent only but not the kind of contract, the valid promises are severable". That test was clearly passed, because under the contract of bailment the plaintiff was entitled at

any time to demand the return of part only of the property bailed without thereby affecting the bailment of the residue. Accordingly the plaintiff could sue in detinue on the contract of bailment in respect of the safe and the gems. The High Court rejected the submission of the company's counsel (at page 393) that "... if any part of the contract is illegal, public policy will not allow any part of the contract to be enforced".

These principles were applied by the Supreme Court of Victoria in *Niemann v. Smedley* [1973] V.R. 769. In that case employees were given the right to an allotment to shares on terms that the company would if desired finance their acquisition over a five year period. The company became insolvent three years later, and the question arose whether the allottees, whose names had been entered on the register, were personally liable for the amounts unpaid on their shares, or whether they could claim that the allotments were illegal and void. One question which arose was whether the illegal provision for company finance was severable from the remainder of the contract constituted by the employee's application for shares (the offer) and notice to him of the allotment (the acceptance). It was held that the promise of the company to finance the acquisition of the shares was not the whole or the main consideration to support the promise of the applicants to pay for the shares, but was subsidiary to the main purpose of the contract - a contract to acquire fully paid shares in the company. Accordingly, the term by which the company agreed to provide finance was severable from the rest of the agreement, which remained valid, and accordingly the liquidator could recover capital unpaid on the shares. In the course of their decision, the Court said this (at page 778):-

> "An illegal term, as distinct from one merely void [for uncertainty], may raise different considerations for if it is of a kind involving a serious element of moral turpitude or is obviously inimical to the interest of the community so as to offend almost any concept of public policy it will so infect the rest of the contract that the courts will refuse to give any recognition at all to the contract, e.g. a promise to commit a burglary or to defraud the revenue or one *contra bonos mores*. But such class of cases apart, where the illegality has no such taint, the other terms will stand if the illegal portion can be severed."

It is necessary to refer briefly to a recent decision of the Court of Appeal of New South Wales, *DJE Constructions Pty. Limited v. Maddocks* [1982] 1 NSWLR 5, in which the *Niemann* case was distinguished. The company, which had in issue only two one-dollar

shares, needed to increase its issued capital by $5998 in order to qualify for a licence from the Builders' Licensing Board. In order to achieve this result Reilly, who did not however possess the requisite funds, drew a cheque on her bank account in favour of the company for $5998 to pay for an allotment of shares in favour of Maddocks. In order to cover Reilly's cheque, the company then drew a cheque on its own banking account in favour of Logan for the same amount, which Logan deposited in Reilly's bank account. This sum was shown in the company's account as a loan to Logan. The 5998 shares intended to be issued appeared in the company's statutory returns as allotted to Maddocks, but only an unsealed share certificate in his name existed and his name was not entered on the Register of Members. Maddocks took proceedings against the company for rectification of the register by the entry of his name as the holder of 5998 shares. His claim failed. In the course of his judgment Street C.J. said this (at page 10):-

> "Whilst the doctrine of severance can be applied in proceedings brought in the context of a contract illegal and void by reason of an infringement of a statutory provision (*Thomas Brown & Sons Limited v. Fazal Deen*), I know of no case in which it has been applied in a claim for the actual enforcement of such a contract. The principles relating to severability were developed in connection with contractual clauses void for uncertainty and for restraint of trade, and not in cases involving contracts illegal and void."

He then considered the *Niemann* case and added (at page 11):-

> "With the greatest respect I do not consider that the doctrine of severability is available to save an integral term of an agreement such as the method of paying for shares that are being agreed to be issued in contravention of a section such as is presently under consideration. The distinction to be observed in the operation of the doctrine of severability as between contracts that are merely void and those that are illegal and void is adequately noted in Halsbury, [certain references being given]. In the light of the long-standing distinctions between a clause which is purely void and a clause which is illegal and void, I have some difficulty in accepting the correctness of applying the doctrine of severability in a situation such as existed in *Niemann v. Smedley*."

The approach of Samuels J.A. was somewhat different. He said this (at page 21):-

> "It is arguable that a contractual term cannot be severed if it involves the doing of an act which is *contra bonos mores* or illegal at common law ... or

> by statute ... and the company's loan to Mr. Logan amounted to a criminal offence under section 67(3) punishable by imprisonment. It appears, however, that this limitation cannot stand with the decision of the High Court in *Thomas Brown & Sons Limited v. Fazal Deen*, where one term of a contract was severed from the rest, although its performance necessarily contravened a provision of the National Security (Exchange Control) Regulations and was thus subject to any penalty prescribed by the regulations, or constituted an indictable misdemeanour at common law."

He came however to the same conclusion as the learned Chief Justice on the ground that:-

> "... the allotment was dependent upon the loan, and the illegality of the loan infected the whole of the contract. This was not an ordinary contract to take shares. Its fundamental objective was to enable the company to satisfy the requirements of the Builders' Licensing Board. It was a device to achieve that purpose; and an unsuccessful one as it turned out because the shares never were paid up in cash."

Glass J.A., who was the third member of the Court, agreed with the result, but did not express a preference between the two approaches.

With great respect to the learned Chief Justice, their Lordships consider that the approach of Samuels J.A. was correct. Furthermore, so far as the Court of Appeal was concerned, the *Fazal Deen* case was a decision of the High Court and concluded the matter; in that case the plaintiff sued to enforce a contract of bailment a part of which contract was illegal, but he was allowed to succeed in relation to the lawful part of the contract.

In the light of the law as it has been developed in Australia and England, and also in Scotland though their Lordships have not been referred to the Scottish case law, their Lordships feel no doubt in the instant case that the illegal provision of the debentures can be severed from the composite transaction, leaving the vendors free to enforce the sale agreements against Ilerain and the guarantee against Mr. Carney; and that the nature of the illegality is not such as to preclude the vendors on the ground of public policy from enforcing their rights under those documents. Before however their Lordships further elaborate their reasons, they will refer to two cases which bear a close resemblance to the present case.

The first of these cases is *South Western Mineral Water Co. Limited v. Ashmore* [1967] 1 W.L.R. 1110,

decided by Cross J. (as he then was) in the Chancery Division of the English High Court. Ashmore had entered into a somewhat odd agreement with the Mineral Water Co. (in effect) to buy the shareholding of its subsidiary Solent Products Limited. A part of the purchase price was to be paid at once, and the balance at the end of eight years, secured by a debenture to be charged on the assets of Solent and guaranteed by Ashmore. Ashmore paid the first instalment of the purchase price and was let into possession of certain assets which were intended to be the effective subject matter of the purchase. A number of matters were in dispute between the parties, and Ashmore declined to pay the first half-year's interest due under the intended debenture (which had not been issued) until the Mineral Water Co. had completed certain conveyances. Thereupon the Mineral Water Co. issued proceedings against Ashmore to recover possession of the premises and to rescind the contract; alternatively for specific performance. It is unnecessary to narrate the course of the action. The importance of the case lies in this passage from the judgment of Cross J. (at page 1120):-

> "I cannot take the view and do not take the view that the fact that the granting of this debenture would be a criminal offence by Solent made the whole of this agreement absolutely null and void so that the courts will not allow anybody to rely on any of its provisions. No case that has been cited to me suggests that I am obliged to arrive at so ridiculous a conclusion. The position was this, I think, that if the company were prepared to waive the obligation of Solent to provide the debenture and were prepared to complete the transaction on the footing that they merely had the personal undertaking of Mr. Ashmore to pay the £36,500 over eight years with 8 per cent interest secured only by the £9,000 securities and without any charge on the assets taken over by Solent, they were at liberty to enforce the contract on that basis. But, in fact, the company are not prepared to do that. They say that it is an integral part of the arrangement that there should be a debenture. I think they are right on that point. It was so substantial a part of the consideration that though they could waive it and enforce the contract without it if they liked, Mr. Ashmore could not compel them to complete on that basis. Alternatively, I think that Mr. Ashmore, if he was willing to waive the period of eight years for the payment of the purchase-money, which was inserted obviously for his convenience, and pay the £36,500 down, he was at liberty to do that, and I do not think the company could have refused to accept the money and, quite clearly, they would not have refused. However, Mr. Ashmore was unwilling to pay it."

Their Lordships agree entirely with what fell from Cross J. It should however be observed that when Cross J. spoke of the right of the company to "waive" the obligation of Solent to provide the debenture, he did not mean waiver in the strict sense. The company had nothing to waive, because the obligation to provide the debenture was void for all purposes. The sense of the passage is that if the company were content to continue with the contract notwithstanding that no debenture could be granted by Solent, it was at liberty to do so and to enforce it on that basis.

The second of the cases is *Firmin v. Gray & Co. Pty. Limited* (1984) 2 ACLC 338, decided earlier this year by the Supreme Court of Queensland on appeal. By a written contract Firmin and his co-plaintiffs agreed to sell their shares in Firmin & Co. Pty. Limited to Gray & Co. Pty. Limited. The contract, which provided for payment of a 10 per cent deposit, contained a term (clause 22) that the purchasing company should arrange for the Firmin Co. to execute a mortgage to secure the payment of the balance of the purchase-money to the vendors. A little later it was realised that clause 22 contravened section 67. The purchasing company claimed the right to rescind and to recover its deposit. The vendors claimed that clause 22 was severable and capable of being "waived" by them and it was thereby "waived". The vendors then called on the purchasing company to complete. The purchasing company failed to complete, whereupon the vendors brought an action for a declaration that the deposit was forfeited. They succeeded at the trial and on appeal. It is unnecessary for their Lordships to refer to the judgments in the Supreme Court, which are based on the same line of reasoning as is to be found in the *Mineral Water* case.

The contract in the present case was basically one for the sale by the plaintiffs to Mr. Carney or his nominated company of shares in Airfoil. The mortgages, like the guarantee, were ancillary to that contract for the sole purpose of ensuring the due performance of the contract by the purchaser. Mr. Carney wanted only the shares in Airfoil. The plaintiffs wanted only the purchase money. It made no difference to the plaintiffs, or to the nature of the transaction, what security was provided so long as it was satisfactory security. The mortgage did not go to the heart of the transaction, and its elimination would leave unchanged the subject matter of the contract and the primary obligations of the vendors and the purchaser. The debenture is therefore capable of being severed from the remainder of the transaction, and its illegality does not taint the whole contract. There is no public policy objection to the enforcement of the contract from which the debenture has been divorced. The *Mineral Water* case is an authority that there is no public

policy objection to such a course so far as the law of England and Wales is concerned. The *Firmin* case is a like authority so far as the State of Queensland is concerned. There is no reason to suppose that the public policy of the State of New South Wales is any different.

There is one final point on this aspect of the case to which their Lordships wish to allude. It was argued by the appellant that on the true interpretation of the evidence the vendors, at the time when the contract was made, required a mortgage on the property of Newbridge as an essential security for the payment of the purchase-money, and that they would have declined to enter into the contract at all if they had been told that such a mortgage would not be forthcoming. Therefore, it is said, the mortgage is not severable from the remainder of the transaction, since severability must be judged at the moment when the contract is concluded according to the then intentions of the parties. There are observations by the Supreme Court of Victoria in *Brew v. Whitlock (No.2)* [1967] V.R. 803, at page 811 line 49 to 812 line 7, which might be read as giving some support to this proposition. In the opinion of their Lordships there is no such principle applicable to the instant type of case. Furthermore it is manifest in the *Mineral Water* case that at the date when the contract was made, had the point then arisen, the vendor company would have declined to conclude the contract without the benefit of the offending debenture, because it did in fact so decline during the trial. Nor in the *Firmin* case did the Court ask itself the question whether at the date of the contract the vendors would have been content to conclude the contract without clause 22. Their Lordships do not accept the relevance of any such inquiry.

Subject to a caveat that it is undesirable, if not impossible, to lay down any principles which will cover all problems in this field, their Lordships venture to suggest that, as a general rule, where parties enter into a lawful contract of, for example, sale and purchase, and there is an ancillary provision which is illegal but exists for the exclusive benefit of the plaintiff, the Court may and probably will, if the justice of the case so requires, and there is no public policy objection, permit the plaintiff if he so wishes to enforce the contract without the illegal provision.

The Airfoil Cheques

It is said by the appellant that it was at all times the intention of the parties that Airfoil cheques should be used to effect payment of the purchase price; that the financing by Airfoil of the

purchase price out of its own banking account was a breach of section 67; and that the intention of the parties that the sale should be concluded in this illegal manner, and the part performance thereof in that way, has the consequence that the plaintiffs cannot enforce any of the provisions of the sale.

The sale agreements themselves did not stipulate for payment of the purchase price out of the monies of Airfoil, but by cash or bank cheque. In regard to the Airfoil cheques, the learned judge said this:-

> "As it happened, the defendant chose to discharge the obligation which Ilerain Pty. Limited had by means of cheques drawn by the company [Airfoil]. However, that is not necessarily inconsistent with a number of ways in which that could have been effected legally. Why should I assume that it was to be done illegally? I do not intend to do so."

In their Lordships' view that is plainly right. Over a week elapsed between the writing out of the first instalment cheques and their presentation for payment. There was ample time for the state of account between Mr. Carney and Airfoil to be organised, if that were necessary, so as to justify such payments; likewise in the case of the later cheques had they been honoured.

The Loan Accounts

The release of liability on the loan accounts involved no breach of section 67. At the date of the contract Mr. Herbert owed $5,000 to Airfoil and Mr. Jehnic owed $7,000. Clearly Mr. Carney would not have wished to hand over to them the full purchase money for their shares without requiring them to discharge their debts to Airfoil. This could have been achieved by requiring them to pay $5,000 and $7,000 to Airfoil at the same time as the first instalments of the purchase price were paid to them. Mr. Carney merely short circuited such an arrangement by causing the respective purchase prices to be reduced by $5,000 and $7,000, and agreeing that Mr. Herbert and Mr. Jehnic should be released from their liability to Airfoil. Mr. Carney could properly do this, because his own loan account was in credit to an amount well in excess of $12,000. His loan account therefore could be, and in default of any other arrangement with Airfoil ought to have been, reduced to the like extent, and in the result the financial position of Airfoil would be totally unaffected by the releases.

Their Lordships will humbly advise Her Majesty that the appeals should be dismissed. The appellant will pay the costs of the respondents.